REWARDS
GROUP LTD
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Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Agribusiness Managed Investment Schemes

Submission by Rewards Group Ltd

The Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

To whom it may concern,

I refer to your letter dated June 3, 2009, regarding the Terms of Reference for the inquiry into Agribusiness Managed Investment Schemes. Please see below the Rewards Group Ltd submission in support of agriculture and forestry MIS.

The agribusiness sector has been plagued by the unprecedented collapse of Timbercorp and Great Southern. The loss of these two companies has been a cause for concern for both investors and stakeholders, but this should not be a reason to consider closing down an investment structure that has pioneered new industries in Australia.

Prior to the development of the managed investment scheme structure for agriculture and forestry; an export plantation pulpwood industry, an olive oil industry, an almond industry, a plantation teak industry, a plantation sandalwood industry, a plantation mahogany industry, a red grapefruit industry, a low chill stonefruit industry, a viable export mango industry, a consolidated strawberry industry, and a plantation brushwood industry, **did not exist.**

Since the 1970's rural industries have been starved of investment. The managed investment structure has since then, facilitated the successful injection of new capital into this burgeoning component of the Australian economy.

Australia remains extremely well positioned to capitalise on the imminent global

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shortage of agricultural products as a result of our abundance in resources and proximity to Asia. Australian agriculture and forestry assets remain strong and continue to be highly sought after by both domestic and international investors.

Globally, Australia must continue to be competitive in attracting new investment into its robust agricultural and forestry sectors. Rewards are committed to successfully growing its forestry, horticultural and viticultural divisions around Australia through the successful deployment of capital and local expertise.

1. Business models and scheme structures of MIS

Managed Investment Schemes are investment vehicles governed by the Corporations Act and regulated by ASIC. The key aspects of an MIS include investors paying money to a manager in the expectation of obtaining a benefit. The investments are pooled and typically investors engage an expert manager to oversee the day-to-day operations of the enterprise from which the benefit will be obtained.

There is over $350B of funds invested in the Managed Investment Scheme industry. Managed investment schemes cover a wide variety of investments. These include;

- Cash management trusts
- Unlisted property trusts
- Property trusts
- Australian equity (share) trusts
- Many agricultural schemes (e.g. horticulture, aquaculture, racehorse syndications)
- International equity trusts
- Some film schemes
- Timeshare schemes
- Mortgage funds, including unlisted mortgage funds
- Actively managed strata title schemes

Agricultural and Forestry Schemes represent approximately 2% of the total funds in this investment structure. Due to the long term illiquid nature of agribusiness activities, the closed end fund structure that represents a managed investment scheme provides a robust method to attract investment capital to the sector.

Agriculture and Forestry are long-term businesses. They are businesses that traditionally take decades to develop. Previously, investment into this sector was only undertaken by existing primary production enterprises, high net worth individuals and Government. Due to the long-term illiquid nature and the tax treatments for institutional funds and offshore investors, agribusiness is not considered to be a component of mainstream investment.

Coupled with its relatively modest returns, this is the key reason why there has been so little investment in this industry in comparison to other sectors of the Australian economy. Agriculture and Forestry may not be guaranteed investments, but both provide exposure to an asset class that is a requirement of everyday life, and one that existed well before currencies, banks and Government

The managed investment scheme structure provides a very effective mechanism to inject capital into industries with a lower profile. Despite this, the agribusiness sector has attracted less than 2% of the managed investment scheme funds invested in Australia. This demonstrates how difficult it is to attract capital to this sector.

The collapse of the parent company of two ASX listed companies as a result of poor financial control does not mean that there is a fundamental problem with the investment structure, nor the assets being developed. The primary reason for the collapse of these two organisations was debt structuring in the parent company.

Both company's overpaid for assets and granted loans to investors that were non conforming (sub prime). Any company in any sector is doomed to fail using this business acumen. There are thousands of companies around the globe that have ceased to exist in the last 12 months due to similar business models.

There are many examples of successful agribusiness schemes in Australia, which have used the managed investment scheme model to inject capital into new and viable opportunities. A well documented example of this is the Red flesh Grapefruit industry, which our company pioneered in Australia. This $20M per annum, industry did not exist in Australia prior to the Rewards Group Tropical Fruits Projects in Kununurra, Western Australia. The injection of approximately $12M of investment capital in the remote Kimberley region will produce approximately $20M of annual income and more than 200 jobs for the region.

The structure and operation of Managed Investments Schemes are extremely robust. Australian Corporations Law and specifically the MIS provisions by which Rewards Group issues investment products, have strong investor protection measures in place. The measures are premised on the growers' property rights and tenure rights over the crops that comprise their investments, including the requirement that the land being used by the scheme is the subject of a registered lease or similar safeguard.[1]

Like all sectors, the market will ultimately distinguish the good business models from the bad ones. However, this is no reason to remove a vital source of funding to rural industries and communities. The focus must remain on the farming enterprise and output, not the performance of an ASX listed parent company.

2. Impact of past and present taxation treatments and rulings related to MIS

1 **Rewards Group, MIS Act 1998**
http://www.rewardsgroup.com.au/cms/rg/pages/InvestinginAgribusiness/MISAct1988.html

Investors have traditionally been entitled to an upfront tax deduction for their investment in agribusiness MIS. This fiscal policy has assisted in attracting much needed capital to burgeoning primary production industries. In early 2007 the ATO said it could no longer issue product rulings for agribusiness MIS. The ATO took into account developments in case law that had cast doubt on the deductibility of investments in both forestry and non-forestry MIS schemes.

In October 2007, the ATO issued a ruling confirming that investments in agribusiness MIS offered after 1 July 2008 would not be tax deductible. This ruling did not ultimately affect forestry MIS because the Government introduced legislation to specifically deal with this type of agribusiness MIS. Investors in forestry MIS (offered after 1 July 2008) are entitled to an upfront tax deduction for their investment, provided that at least 70 percent of the MIS expenditure was directly related to developing forestry.

This action by the Federal Government and the ATO had devastating affects on the industry. Capital inflows were dramatically reduced, which ultimately predicated the demise of the industry's two largest operators.

On 19 December 2008, the Federal Court of Australia ruled on the test case. The outcome, which followed a unanimous decision by the full bench of the Court, was that contributions to non-forestry MIS can be treated as tax deductible. The ATO subsequently confirmed this decision stating in a media release that investments in MIS arrangements which are broadly similar to the test case are deductible.

The outcome of the test case provides certainty for investors that an investment in agribusiness MIS is tax deductible. It is important to note that the tax treatment for investors covered by existing product rulings remains unchanged.[2]

The timing of the Federal Court decision, (December 2008), did not permit sufficient time for the industry to develop projects, obtain product rulings or raise capital for non forestry investments in 2008 and 2009. This resulted in almost zero investment capital for horticultural schemes in 2009 and a potential loss of more than $400M (2008) of funds for rural industry development

3. Any conflicts of interest for the board members and other directors

All conflicts of interest must be addressed by the Compliance Committee. As part of the Compliance Plan for each and every registered managed investment scheme, any conflicts of interest must be detailed and resolved. If any conflicts are identified, it is the responsibility of the Compliance Committee to ensure that any dealings are commercial in terms.

4. Commissions, fees and other remuneration paid to marketers, distributors, related entities and sellers of MIS to investors

2 **MIS Test Case Q&A, http://www.macquarie.com.au/retail/acrobat/agribusiness_mis_flyer.pdf**

Commission structures for agribusiness managed investment schemes are wrongly perceived to be too high. An agribusiness scheme generally pays remuneration to a licensed financial planner of between 6-10% of the application fee. In mainstream retail funds (equities/bonds/mortgages), commissions payable to financial planners are between 3-6% upfront with ongoing trail payments of 0.5-1%.

Initial Public Offerings for companies raising equity for a public listing pay brokers between 2-6%, not including further potential equity participation. Given the long term nature of agribusiness investments (15-20 years), the current commission payments made to financial planners are hardly unreasonable.

As a provider of investment products we would welcome any savings in our capital raising costs, however, given the alternative nature of the asset class and the length of the investment period, it would be difficult to attract interest from the investment community with large reductions in distribution remuneration.

5. **The accuracy of promotional material for MIS, particularly information relating to claimed benefits and returns**

The only promotional material permitted for use is a Product Disclosure Statement. The standards applied to the issue of Product Disclosure Statements are unprecedented around the world. In comparison to the other capital raising documents issued in Australia, the disclosure standard is extremely high.

As a provider of investment products, every statement and every assumption in our Product Disclosure Statements requires information from an independent source. These sources are independent industry experts, government publications and industry bodies. Upon completion of a Product Disclosure Statement, the documentation is reviewed by external legal counsel and a due diligence committee.

In addition to the PDS, prospective investors have access to independent research reports from leading agricultural and forestry research agencies. These reports critically analyse all aspects of the scheme, from technical assumptions to investment structure, to corporate governance procedures. These reports form the basis by which licensed financial planning dealer group investment committees decide on a recommendation.

6. **The range of individuals and organisations involved with the schemes, including the holders of a relevant AFS licence**

A company issuing investment products to the Australian retail market must by law hold an Australian Financial Services Licence. Rewards Projects Ltd is the holder of an AFS Licence. Under the terms of the licence, there are strict requirements and conditions placed on the Responsible Entity by ASIC. These conditions are lengthy and very onerous and will not be elaborated on in this submission.

Importantly, the AFSL holder must have demonstrated skills, professional qualifications and experience in each and every field in which the company issues products. For example, before a responsible entity issues a forestry product, it must have at least one tertiary qualified forester employed as the Responsible Officer for the AFSL.

7. The level of consumer education and understanding of these schemes

The position is strong for consumers as growers will typically participate in a scheme as part of a diversified portfolio of investments, which have been recommended by a qualified financial planner.

MIS is no stranger to consumer education. However, recent poll results suggest a lack of complete consumer knowledge and understanding of **ALL** financial products in Australia. Agribusiness products by nature are far easier to understand than the majority of managed investments. The investors interests are real (trees) and their claim to a distinct piece of land makes the investment, tangible and transparent in comparison to most complex financial structures.

The consumer education problem is not isolated to MIS and is a critical issue that the Federal Government needs to address. The extremely low proportion of the Australian populous that has an active engagement with a financial planner (<20%) is clear evidence of this.

8. The performance of the schemes

The past five years have been the biggest for MIS investment. Total investment in that time has been $5.048 billion including $3,346 million to various types of Timber, $912 million to permanent plantings like almonds and olives, $320 million to viticulture, and $470 million to others such as cattle and grains. Forestry MIS has been pivotal to the success of the Federal Governments ‘Plantations for Australia: The 2020 Vision’, a strategic partnership between the Commonwealth, State and Territory Governments and the plantation timber growing and processing industry.

The overall performance of schemes is difficult to ascertain given the relative immaturity of the industry. Whilst some of the earlier pulpwood schemes did not perform in line with expectations, it is important to note that they have not been failures. Like all pioneering rural pursuits there will be teething problems. This has some similarities to the government funded and managed Radiata Pine Industry, which was developed after the Second World War. It was not until some 40 years later (in the 1980’s) that the industry achieved results that were acceptable to the investment community.

Primary production pursuits contain technical and environmental risks. Investors in pioneering projects are constantly exposed to higher technical risks than mature industry. And agricultural industries will always have an exposure to environmental risks. The Rewards Group has established 34 schemes across 11 industries in Australia since 1999.

Rewards are harvesting produce on behalf of investors in these schemes 365 days a year. To date we have harvested in excess of $40M million of produce to the benefit of our investors. All of our farms and business units are viable and prosperous. In the 2009 and 2010 financial year, the harvest yield is $30 million for the benefit of the investors.

9. **The factors underlying the recent scheme collapses**

There were a number of factors that led to the downfall of Great Southern and Timbercorp, however none of which have any reflection on the structure of the Management Investment Act and its application to primary production. It is very important to separate the companies from the schemes. The schemes **HAVE NOT** collapsed. The asset manager **HAS** collapsed. The assets still exist and continue to exist either under a new manager or a new structure.

The key factors resulting in the collapse of Timbercorp and Great Southern are;

- **Regulatory Uncertainty**
  - The removal of the ATO Product Ruling 2000/7 by the Government, pending a test case in the Federal Court, created high levels of uncertainty for the whole investment industry.
  - Ultimately this created reduced income flow to the industry on capital intensive horticultural and viticultural assets. This action by the Federal Government was unprecedented.
  - For a government to disallow an industry to operate whilst it conducted a legal review is extremely damaging. It has also been a negative outcome for the ATO and has left it open to significant liability claims form investors and shareholders.
- **Corporate Debt**
  - Like many companies caught in the midst of the global financial crisis, increasing debt levels and the inability of both companies to roll over debt or access new equity, resulted in the secured banking partners ceasing their support of the two businesses.
- **Investor Loan Debt**
  - Both companies granted loans to investors to participate in the schemes. However, large proportions of these loans were non conforming (sub prime) and could not be realised as cash. Cash funds are required in order to establish and manage these schemes.
- **Asset Depreciation**
  - A significant component of these companies’ assets is located in the Murray Darling Basin. This region has been struck by sever price deflation of assets as a result of the sever drought conditions.
- **Rising Input Costs**
  - Farming enterprises around the world are coming under severe margin pressure; as a result input costs on key items such as fertiliser, herbicides and labour are rapidly increasing.

Rewards requests that the Committee make a strong distinction between factors relating to forestry and horticulture practices, and those directed at financial arrangements and the projections of promoters, sales managers and financial advisers, which are entirely different factors.[3]

10. **The projected returns and supporting information, including assumptions on product price and demand**

Independent market analysts have quantified that the gross revenue for investment into the managed investment industry from 2004 to 2008 be estimated at $25.581 billion over the project's lifetime. Even allowing for significant underperformance, this substantially exceeds the investment made and the tax deductions permitted, which are believed to be approximately $2.5 billion. When extrapolated out to include all investment inflows since the commencement of managed investments, this equates to a very significant injection into rural Australia.

Every investment has risks. Under the Australian Corporations Law, we have very strict guidelines and procedures that providers of investment products must comply with. In the case of managed investments, the promoter is required to hold a financial services licence issued by ASIC and must produce a Product Disclosure Statement (PDS) for each investment offering. The PDS must clearly outline all the costs and risks associated with the investment product.

All assumptions on each key component of the investment must be supported by independent data and analysis by a 3rd party. The 3rd party information is sourced from industry leading experts in their respective technical fields. In addition, the supporting assumptions in a scheme must be authorised by a Due Diligence Committee and the Compliance Committee of the Responsible Entity prior to issuing the PDS.

Before a PDS is issued, the financial planning community and independent research and rating houses must review the project. These reviews include all components of the scheme including corporate governance, past managerial performances and all the assumptions utilised in the scheme. These Research Reports are then analysed by Investment Committees of the Financial Planning Dealer Groups, before a decision is made on whether to include the scheme on the Approved Product List for a licensed dealer group.

The checks and balances that are undertaken in the agribusiness managed investment scheme industry are unprecedented in Australia. The levels of consumer protection and information sources are extensive and provide a very transparent knowledge base for all stakeholders.

Due to the long term nature of agribusiness investments, ASIC policies do not permit the investment product provider to publish forecasts or forward looking statements.

3 **Institute of Foresters Australia, http://www.forestry.org.au/**

Indicative forecasts are available from ratings reports, which are available from independent research organisations who undertake their own analysis

11. **The impact of MIS on other related markets**

MIS has forged a strong presence in rural Australia and has established itself as a key emerging industry. MIS has channelled significant investment into rural areas over the past decade and has in the process made a substantial contribution to the market.

The key items to consider when assessing the impact of MIS include;

- **Global shift in corporate farming trends**
  - Since the 1950's there has been a global shift towards corporate farming enterprises.
  - Australia has been one of the last developed countries to embrace this requirement of modern agriculture.

- **MIS does not distort produce markets**
  - MIS has not distorted produce markets nor pricing in the Australian domestic market.
  - Fresh produce markets are extremely competitive and none more so than the Australian domestic market with the domination of Woolworths and Coles.
  - Larger, more efficient farming operations are required to keep production costs low in order for producers to be domestically competitive and have international credibility.

- **Competition for land**
  - Agriculture and forestry are just two of many practices competing for land in rural Australia.
  - MIS agriculture and forestry projects must compete with broad-acre cropping, dairy, beef, wool, rural property development and urban expansion.

- **Demand**
  - MIS has increased the demand for agriculture and forestry products in the domestic and international market.
  - Since the birth of MIS, both sectors have become extremely attractive investments for not just the city investor but also the global investor.
  - MIS has injected millions into the agriculture and forestry sector and has helped safeguard the survival of traditional farming.

- **Jobs**
  - MIS has created jobs for more than 2,300 people on a direct basis, and over 3,100 on a contract basis.[4]
  - Independent studies have concluded that the MIS industry would not elicit a population decline in rural areas.
  - In the wake of MIS, the rural population has grown exponentially. MIS has

4 **Time for some MIS facts, Australian Agribusiness Group, http://www.ausagrigroup.com.au/**

attracted working families and youth, two demographics whom perhaps would have never relocated from the city to rural areas.

- MIS has not only created new jobs for these two demographics but has also encouraged exciting new business ventures which have been to the benefit of rural areas.

12. **The need for any legislative or regulatory change**

Rewards' does not believe that there is a need for any wholesale amendments to the framework of managed investment schemes. The overall structure is a highly efficient method for attracting capital to the non-mainstream asset classes that require long-term funding. Our Group would support any amendments that would permit further consumer protection measures and a wider base of investors (superannuation/institutions) that are focused on the core fundamentals of the farming and forestry sector.

MIS has been greatly successful in the initiation and development of new rural industries in Australia. To destroy this effective financial structure would not only deny Australian investors access to this very important asset class, but also destroy capital injection into the declining Australian rural sector.

Yours sincerely

Craig Anderson
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